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EY REIT alert
Real Estate Investment Trusts introduced in Ireland
Introduction

As announced in last December’s Irish Budget, Ireland’s 2013 Finance Act contains measures facilitating the establishment of Irish Real Estate Investment Trust (REIT) structures, with the main objective of attracting international investment into the Irish property market. REITs are a globally recognized standard for investing in real property assets and, as expected, the Irish legislation, for the most part, follows the regime developed in the United Kingdom.

In Ireland, a REIT will be an Irish incorporated company that is required to be listed on the Irish Stock Exchange or the main market of a recognized stock exchange in a European Union (EU) member state. It will be able to hold both Irish and overseas real estate assets, with the aim of providing a low-risk, liquid investment vehicle for investors looking to gain exposure to the Irish real estate market.

Initially, a REIT will have to meet certain criteria to enter into the regime, and then meet additional criteria annually at the end of the specified accounting period where it has applied to be a REIT. REITs that meet these conditions will not be charged to Irish corporation tax on their net rental profits or on property gains from their property rental business, however there will be a withholding tax of 20% on all distributions.
Establishing and ongoing conditions of a REIT

A REIT must give notice to the Revenue Commissioners (Revenue) on the date it intends to join the regime (not being earlier than the date of the notice), and it must provide a statement to Revenue that it will meet the following conditions on entering the regime:

1. It must be an Irish resident company (cannot be dual resident).
2. It has been incorporated under the Companies Act.
3. It must be listed on the main market of a recognized stock exchange in an EU member state.
4. It must not be a close company, which for these purposes broadly means it cannot be controlled by five or fewer participators.

For conditions 3 and 4, the legislation has introduced a three-year grace period to meet these conditions. This is a positive move, as it will allow existing and new property companies to immediately enter the regime, and then have three years to increase their investor base and budget for the additional compliance costs of a full market listing.

Once entered into the regime, the REIT must meet ongoing conditions and make an annual statement to Revenue in respect of each accounting period by 28 February following the end of the respective accounting period. These ongoing conditions are:

1. At least 75% of the REIT’s aggregate income must be derived from the property rental business, excluding capital gains/losses.
2. It must carry on a property rental business consisting of at least three properties, and no single property can represent more than 40% of the total market value of the properties constituting the property rental business.
3. It must meet an annual property finance cost ratio where the ratio of the property income (profits) plus the financing costs to the financing costs cannot be less than 1.25. Where the ratio is less than 1.25, then a tax charge may be payable by the REIT.
4. At least 75% of the REIT’s aggregate market value of assets must relate to the property rental business.
5. The aggregate value of any specified debt cannot exceed an amount equal to 50% of the aggregate market value of the REIT’s business assets.
6. Subject to having distributable reserves, it must distribute annually 85% of its net rental profits.

There is also a three-year grace period in relation to condition 2. This again is a positive move with regards to attracting new or existing property companies to the regime, as it provides a three-year window to source and fund the desired property assets. There is, however, a potential corporation tax charge on a REIT if it does not meet the annual distribution limit as set out in condition 6.

If a REIT decides to take on development projects, then the cost of the development can only exceed 30% of the market value of the asset at the date the development begins, when the developed property is held for a minimum of three years from the date of completion. Otherwise, any profits from the sale of the development will be chargeable to corporation tax, which is currently at the rate of 25%.

If a REIT disposes of a property asset that is used for the purpose of the property rental business, then the proceeds from the disposal can be held for up to two years, with any income from those proceeds being exempt from corporation tax. Thereafter, unless reinvested or distributed, the proceeds will be treated as normal business assets and not assets of the property rental business.

Taxation

If an existing company decides to obtain REIT status, it is deemed for corporation tax purposes to have disposed and reacquired the assets at market value on the date it gives the Revenue notice it wants to becomes a REIT. This may give the company a corporation tax exposure at the current capital gains tax rate of 33%; however, given the decline in Irish property values in recent years, this exposure may be limited. Consideration will also be required on the capital allowance position for each asset deemed disposed / reacquired, as this may create a separate corporation tax exposure at the rate of 25%.
As the REIT is not chargeable to corporation tax on its net rental profits and capital gains, it passes the tax obligation onto its investors. The legislation provides, however, that Ireland will maintain its taxing rights on the net rental profits and capital gains of REITs. It does this by applying Dividend Withholding Tax (DWT) at the rate of 20% on distributions made to all investors, unless the investor is an exempt qualifying investor such as pension funds and certain investment undertakings, etc.

Irish resident individuals will be taxed at their marginal rate of income tax on the gross dividend with a credit given for the DWT. They will also be subject to the Universal Social Charge (USC) and Pay Related Social Insurance (PRSI). Irish resident individuals will be subject to capital gains tax (dependant on their personal circumstances) on any gains made on the disposal of shares in a REIT, which is currently at the rate of 33%.

Irish resident companies will be charged to corporation tax at the rate of 25% on the distributions from a REIT, with credit given for the DWT. They will also be charged to corporation tax on any gains made on the disposal of shares in a REIT, and this will be at the same effective rate for individuals, which is currently 33%.

The one difference for a company is where it receives a dividend from a REIT as part of its trade. In this scenario, the legislation allows for the company to be taxed at the corporation tax rate of 12.5%.

Dividends paid to non-resident investors will be made after DWT as outlined above; however, in certain circumstances the investors may avail of a reduced rate of DWT by recovering a portion of the DWT, depending on their country of residence and the applicable treaty in force between Ireland and the respective country. These non-resident investors, however, will not be liable to capital gains tax on any gains made on the disposal of shares in a REIT, as the shares are publicly listed, and therefore exempt.

Irish stamp duty of 1% will apply to the purchase of shares in a REIT. The REIT itself will pay stamp duty on the purchase of Irish situate property, with the acquisition of residential property charged at 1% on the first €1 million, and the excess taxed at 2%. Non-residential property will be charged at 2%.

One major difference to note between holding shares in a REIT and having a direct holding in Irish property is that property gains should not be taxable in the REIT (subject to conditions). However, if these gains are distributed, Irish individual investors become liable to income tax, USC and PRSI, rather than paying capital gains tax at the rate of 33%, if they had held the property in their own right. Whereas the reverse works for an Irish company investing in a REIT as property gains that are distributed will be taxed at 25% and not 33%.

Summary
Given the real interest in the Irish property market, there is no question that REITs are a welcomed addition to help boost local and International investment. It remains to be seen whether the Finance Act has gone far enough to make Irish REITs an attractive option for Irish and international real estate investment, given there are other investment vehicles and structures readily available which are potentially more tax efficient. On the positive side, the Irish REIT will provide a mechanism for a controlled exit for the National Asset Management Agency (NAMA) or other property companies looking to reduce their balance sheet exposure to Irish property.

So, while REITs add to the structuring options for Irish and international real estate investment, whether they will actually be used will depend on the size, nature and location of both the target assets and the investors.

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Your EY Tax contacts

Global Real Estate

Howard Roth  
Global Real Estate Leader  
+1 (0)212 773 4910  
howard.roth@ey.com

Rick Sinkuler  
Global Real Estate Markets Leader  
+1 (0)312 879 6516  
richard.sinkuler@ey.com

Ad Buisman  
EMEIA Real Estate Leader  
+31 (0)88 407 9433  
ad.buisman@nl.ey.com

Irish Real Estate

Donal O’Sullivan  
Partner  
+353 (0)1 2212 455  
donal.osullivan@ie.ey.com

John Heffernan  
Partner  
+353 (0)61 317 784  
john.heffernan@ie.ey.com

Billy McMahon  
Executive Director  
+353 (0)1 2212 738  
billy.mcmahon@ie.ey.com

Dominic Rigby  
Senior Manager  
+353 (0)1 2212 940  
dominic.rigby@ie.ey.com

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Ernst & Young, Harcourt Centre, Harcourt Street, Dublin 2, Ireland.

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